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RUEHKM/AMEMBASSY KAMPALA 2324
RUEHNR/AMEMBASSY NAIROBI 4755
RUEAIIA/CIA WASHDC
RUEHGV/USMISSION GENEVA 1414
RHEHAAA/NSC WASHDC
RHMFISS/JOINT STAFF WASHDC
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
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UNCLAS SECTION 01 OF 04 HARARE 000614

SENSITIVE
SIPDIS

AF/S FOR S. HILL
NSC FOR SENIOR AFRICA DIRECTOR B. PITTMAN
STATE PASS TO USAID FOR L.DOBBINS AND E.LOKEN
TREASURY FOR J. RALYEA AND T.RAND
COMMERCE FOR BECKY ERKUL
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS

E.O. 12958: N/A
TAGS: ECON ETRD PGOV ASEC ZI
SUBJECT: ZIMBABWE'S MANUFACTURING SECTOR REELS UNDER
RUINOUS POLICIES

REF: A. HARARE 416
¶B. 07 HARARE 951

SUMMARY

¶1. (U) According to a survey carried out by the Confederation of Zimbabwe Industries (CZI) covering 2007, Zimbabwe's manufacturing sector, once the backbone of the economy, is stricken by the weight of innumerable, largely man-made constraints. Output and employment within the sector have declined sharply due to under-utilization of installed capacity. Solving the sector's problems requires implementation of reforms that restore macroeconomic stability and encourage exports. In the meantime, there is no end in sight to the downward slide of this former pillar of the economy. END SUMMARY

Pale Shadow of Former Self

¶2. (U) Macroeconomic problems afflicting Zimbabwe have taken their toll on the country's once renowned and highly diversified manufacturing sector. Although it accounted for more than 20 percent of Gross Domestic Product (GDP) between 1980 and 1990, it declined even more rapidly than GDP as a whole, and its share of GDP shrank to just over 17 percent in
¶2007. Moreover, the proportion of labor employed in the sector has fallen in lockstep with the decline in output. Data from the CZI show that employment levels for a sample of 100 manufacturing firms fell by 28 percent from 2006 to 2007 compared to a fall of 12.2 percent registered during the

previous year. In line with these developments, manufactured exports also declined from around 45 percent of total exports between 1980 and 1990 to 17 percent, according to Reserve Bank of Zimbabwe figures, in 2007. (Agricultural exports have declined even more rapidly; the minerals sector now makes up half of export shipments.)

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Output Tumbles as Capacity Utilization Plummets
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¶3. (U) According to CZI's survey of 100 firms in the first half of 2008, manufacturing output declined by 28 percent during 2007 compared with an 18 percent fall recorded in ¶2006. This decline reflected, in the main, a number of constraints that the sector faced during the period under consideration which, in turn, resulted in a significant fall in capacity utilization. The weighted average capacity utilization for the sampled firms declined from about 33 percent in 2006 to 18 percent in 2007. Of the firms surveyed, only 4 operated above 74 percent capacity while 76 operated below 50 percent.

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Foreign Exchanges Shortages Still An Albatross
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¶4. (SBU) The shortage of foreign exchange has been a major constraint to operating at full capacity given that the sector is a net user of forex. Firms cannot access badly

needed capital replacements and spare parts for their existing and increasingly obsolete capital stock. Zimbabwe's largest brewer, Delta Beverages, is a case in point. Executive Director Sam Mushiri told us that Delta was nursing old machinery to keep production going primarily for lack of foreign exchange. Moreover, firms cannot access imported raw materials needed for production. Eighty percent of the sampled firms regarded lack of foreign exchange as a binding constraint on increasing output. A number of firms cited the Reserve Bank of Zimbabwe's practice of raiding their foreign currency accounts (FCAs) as a major production impediment, noting that it was pointless to export if one could not get the export proceeds in a timely manner to maintain the production cycle.

¶5. (U) Until the recent partial liberalization of the foreign exchange market (Ref A), the shortage was exacerbated by the overvaluation of the Zimbabwe dollar relative to currencies of Zimbabwe's trading partners. With Zimbabwe's rate of inflation much, much higher than the weighted average inflation rate of its trading partners, the exchange rate was appreciating massively in real terms and thereby rendering exports unprofitable in Zimbabwe dollar terms. As a result, and due to shortages of raw materials and foreign exchange, Zimbabwe's exports failed to grow in real terms. Of the surveyed firms, 52 percent welcomed the partial liberalization of the foreign exchange market in April 2008, given that they began to get a fairer price for their exports in Zimbabwe dollar terms. Most exporting firms expected to raise their export-output ratios in the near term.

Higher Inflation Curtails Domestic Demand

¶6. (SBU) Domestic demand also fell sharply as hyperinflation decimated disposable incomes. Nineteen percent of the sampled firms highlighted low domestic demand as having driven them to operate below capacity. Given that most firms, for fear of being taken over by government, are scaling down production rather than closing, and given the collapse in real wages, unemployment has risen. According to the survey, some workers have opted out of employment as most companies are failing to pay a living wage while other

companies, such as Cairns Holdings Ltd, have adopted survival strategies such as reducing the work week and placing workers on forced leave. These developments reduce domestic demand further.

Price Controls Never Work

¶7. (SBU) The strict price controls introduced in June 2007, but relaxed somewhat two months later, had a debilitating effect on manufacturing output. According to the sampled firms, the National Incomes and Pricing Commission (NIPC) took over the pricing of all basic commodities, but the delays in approving price increases arising from genuine cost increases left most of them operating at a loss that became unsustainable over time as domestic inflation rose sharply. In other words, the pricing models lagged behind the trading cycle. In addition, the NIPC's use of the official fixed exchange rate in pricing models without due regard for the

depreciating parallel market exchange rate used by many firms to source foreign exchange meant that most products were selling at a loss, which acted as a disincentive to continued production. Consequently, most firms cut back on production, resulting in the observed low capacity utilization levels during the period under review. Marah Hativagone, president of the Zimbabwe National Chamber of Commerce, told us in July 2008 that more and more companies were selling their goods &out the back door8 to circumvent price controls and keep the business going.

Shortage of Domestically Sourced Inputs

¶8. (SBU) Some locally sourced inputs also became increasingly difficult to procure as domestic manufacturers scaled down production. Agro-processors are among those adversely affected by the farm invasions that began in 2000 and that led to a sharp decline in agricultural output. Given that the manufacturing sector processes over 66 percent of the agricultural output, any decrease in agricultural production was bound to have a negative effect on capacity utilization in the manufacturing sector. Delta Beverage's Mushiri told us that Delta could not get sufficient inputs of maize meal, water or sorghum to brew Zimbabwe's popular traditional beer. Cairns Holdings Limited, a manufacturer of diverse agro-based products, has similar problems with respect to potatoes. Its Managing Director Phillip Chigumira told us that the few potato suppliers left in Zimbabwe now demanded payment in the form of fuel, as Zimbabwe dollars no longer had value under hyperinflation.

Availability of Domestic Credit

¶9. (U) The introduction of deeply subsidized facilities, such as the Basic Commodities Supply Side Intervention (BACOSSI) (Ref B), designed to boost output in the manufacturing sector, does not appear to have increased production. Most of the firms surveyed stated that the onerous conditions attached to the money, and its rapid erosion in value, wiped out the benefits of low interest rates, as interest rates constituted only a small proportion of the total cost of production. Indeed, Lobel's Bread got BACOSSI funding under terms that did not allow any increase in the price of bread above the controlled price of Z$400 million (now about US$0.01) per loaf. Because other costs are rising fast, and due to flour shortages, the company shut down production this month and sent 1200 workers on leave while the NICP considers its request for a price review.

Comment

¶10. (U) Once renowned for its resilience in the face of adversity, the manufacturing sector is struggling under the onerous weight of the GOZ's populist economic policies. Price controls and overvalued exchange rates, while politically appealing, have the perverse effects of raising prices even faster while also undermining exports as they become highly uncompetitive internationally. With growth

being all about confidence, the extremely low vote of business confidence captured by the survey (2 percent, down from 5 percent in 2006) bodes ill for the future of the sector. Until the GOZ introduces reforms that restore macroeconomic stability and encourage exports, we see no end to the downward slide of this former pillar of the economy.
END COMMENT
Dhanani